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International Economic & Energy Weekly

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13 January 1984

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International Economic & Energy Weekly

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International Economic & Energy Weekly

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Synopsis

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International Economic & Energy Weekly 25X1

13 January 1984

Perspective

The EC Crisis and the French Presidency 25X1

The crisis atmosphere that paralyzed EC decisionmaking throughout 1983 probably will abate in the next six months. The failure in December of the EC summit in Athens has created an unusual sense of alarm among the 10 members over the future of the European Community. This in turn is creating the political willingness to move forward on previously intractable issues, including Community finances, agricultural policies, and enlargement. EC leaders appear to realize that the time for posturing and cosmetic fixes has passed and that compromises must now be made. 25X1

France, which holds the rotating six-month Council presidency during the first half of this year, will push particularly hard to ensure progress is made on resolving a number of intra-Community conflicts, in part because it has unique interests at stake. Paris would like to dispel perceptions that it is the roadblock to European unity and that it is responsible for the budget and enlargement stalemates and the setback at Athens. Moreover, President Mitterrand probably wants to refocus popular attention toward France's leadership role in Europe and away from domestic issues so that the European Parliament elections in June will not be seen as a referendum on his domestic economic policies. 25X1

Paris has already indicated flexibility on a number of key EC issues. As a result, some interim agreement on Community finances and budget burden sharing—the thorniest and most divisive aspect of the EC's crisis—is likely in time for the June EC summit in Paris. After five years of hard bargaining, France appears to have modifed its objection to Prime Minister Thatcher's demand for a "safety net" that limits a member's payments to the EC coffers. French Finance Minister Delors, just before the Athens summit, proposed measures that accepted in principle British and West German arguments that agricultural spending should be brought under control before new revenue sources are discussed. France also appears ready to concede that a member's share of the EC budget should be adjusted on the basis of per capita income. Mitterrand's recent appointment of his close confidant Roland Dumas to handle EC affairs at a ministerial level probably demonstrates his resolve to tackle the tough budget negotiations. 25X1

During the next six months, the Community is likely to move ahead on EC enlargement to include Spain and Portugal, again largely because of an apparent shift in French policy. To protect farmers in its southern provinces, Paris had argued that preaccession negotiations could not be concluded until the EC

made provisions to protect Mediterranean agriculture. The Ten did agree last October on a new policy, and EC leaders in Athens probably convinced Mitterrand that any outstanding French concerns over enlargement could best be mollified through bilateral discussions with Madrid. 25X1

Mitterrand probably hopes that conducting bilateral talks with Spain and pushing ahead with Community preaccession negotiations will balance remaining domestic opposition to enlargement by demonstrating Paris's overall commitment to Community goals while protecting vital French interests. Agricultural negotiations between the Community and the Iberian applicants are expected to begin this month, and some West European officials believe significant agreement on remaining enlargement issues can be reached by early summer. Applicants and members would have 18 months to wrap up final details, gain parliamentary approval, and ratify the treaties before 1 January 1986. 25X1

As EC Council president, France is likely to promote foreign policy cooperation among EC countries and may direct political cooperation discussions toward areas that concern US interests—especially the Middle East and Central America. Paris will want to ensure continued EC support for its cosponsored initiative with Egypt in the UN Security Council but probably will not attempt to fashion significantly new EC initiatives or declarations on the Middle East. Some EC members—especially West Germany—would like the Community to become involved more actively in Central America's economic development. Under French stewardship, the Community probably will seek formal cooperation agreements with Latin American countries and may find itself at odds with Washington over aid to Nicaragua. 25X1

US-EC trade tensions are not likely to increase during the next six months. EC plans to tax vegetable oil consumption—which would have affected US soybean exports—have all but been abandoned. Although limits on imports of feedgrain substitutes from the United States are still being considered, most EC members want to avoid a major confrontation with Washington while focusing on internal EC debates. Nevertheless, France in particular remains extremely critical of US interest rate policies and may try to secure an EC mandate to confront President Reagan on interest rates at the June economic summit in London. 25X1

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Briefs

Energy

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Big Seven Electricity Demand Returns to Normal

After three years of stagnation, preliminary estimates for 1983 indicate that electricity generation was up 3 percent—about 600,000 b/d oil equivalent—compared with 1982. In North America economic recovery combined with unseasonably warm weather in August and record cold in December to

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Big Seven: Net Electricity Generation *Terawatt hours*

	1982	1983 (Estimated)	Forecast 1984	Forecast 1985
Big Seven	**4,180**	**4,300**	**4,444**	**4,607**
United States	2,241	2,322	2,412	2,508
West Germany	345	344	354	368
Japan	520	535	551	565
France	266	277	285	297
United Kingdom	255	258	261	267
Italy	176	173	177	182
Canada	376	391	404	420

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increase electricity generation by 4 percent in the United States and Canada. Electricity generation in France also increased by about 4 percent, largely as a result of increased exports of electric power. Assuming normal weather patterns, we believe electricity generation in the Big Seven will grow by 3.3 percent in 1984 and 3.7 percent in 1985, as the economic recovery spreads to Japan and Western Europe. The bulk of the increase in electricity generation will come from new nuclear and hydroelectric power stations. 25X1

Retail Petroleum Product Prices

The price of retail petroleum products rose in three major West European countries last year despite the $5 per barrel drop in OPEC prices. Higher prices in France, Italy, and the United Kingdom reflect the impact on oil import costs of the strength of the US dollar and the imposition of higher taxes. Gasoline price increases, for example, varied from a 38-cent-per-gallon rise in Italy to an 11-cent-per-gallon increase in the United Kingdom. In Japan and West Germany, product prices remained flat or declined as a result of the drop in crude oil prices. US gasoline prices declined 6 cents per gallon last year despite a 5-cent-per-gallon tax increase in April. Heavy fuel oil prices remained stable or increased in all foreign countries, led by a 25-cent-per-gallon increase in the United Kingdom. The continued strength of the dollar against most foreign currencies suggests that oil product prices are likely to remain on the rise outside the United States. 25X1

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Retail Petroleum Product Prices in Selected Countries [a]

US cents per US gallon

	Gasoline		Light Fuel Oil		Heavy Fuel Oil	
	1982	1983	1982	1983	1982	1983
	Price					
France	229	245	132	142	53	67
West Germany	211	204	124	111	60	60
Italy	264	302	121	164	53	63
United Kingdom	205	216	99	137	76	101
Japan	272	253	157	154	102	102
United States	122	116	117	107	69	68
	Tax					
France	121	132	28	32	8	10
West Germany	103	100	16	16	9	9
Italy	164	202	22	46	7	10
United Kingdom	100	120	4	4	4	4
Japan	85	85	0	0	0	0
United States	15	18	0	0	0	0

[a] All data converted at February 1983 exchange rates.

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[redacted]

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International Finance

Kuwaiti Participation in Brazilian Loan

[redacted]

The Kuwait Foreign Trading Contracting and Investment Company (KFTCIC) has announced that it will participate in the $6.5 billion Brazilian loan required by the IMF as part of its rescue package. The loan should be closed by the IMF's mid-January target, with disbursements beginning shortly thereafter. The decision by the government-controlled company follows a mid-December visit to the Persian Gulf by Brazilian Planning Minister Delfim Netto, who asked Arab government officials to intervene with local banks on Brazil's behalf. Brazil has had difficulty in lining up the last $200 million of the jumbo loan, but observers expect KFTCIC's decision will spur contributions from other Arab bank holdouts. [redacted]

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[redacted]

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Global and Regional Trends

Possible Airbus Materials Problems

[redacted]

[redacted] a major French Airbus facility is conducting rigorous tests on West German–built parts made of composite materials for Airbus A300 and A310 aircraft. The French say their ultimate goal is enhancing the performance and, hopefully, the marketability of Airbus planes in arid and humid climates. We believe, however, they may be experiencing a problem—separation of fabric layers in composite materials—in some of their newest aircraft. If true, Airbus may recall a few recently delivered A300s and

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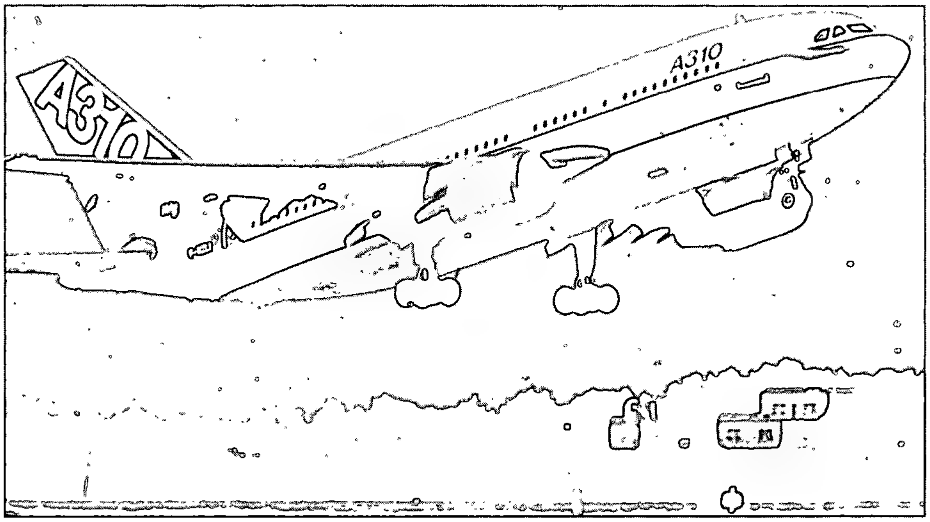

A310 [redacted] 25X1

A310s for parts replacement and may delay deliveries of others until suspect parts can be replaced. Should in-flight failures occur, this probably would not pose a safety hazard, because in commercial airframes such parts are used only in non-load-bearing structures. The impact on the forthcoming 150-seat A320, which is planned to contain more composite airframe parts than any other sizable commercial airplane and is planned to enter service in 1988, is likely to be minimal. Airbus parts designers could use several solutions to their materials problem: special fasteners, stitching, or "3-D" (interplanar) weaving could be used, albeit at increased cost. [redacted] 25X1

National Developments

Less Developed Countries

Mexico's Moderate Wage Settlement

[redacted]

The moderate increase in minimum wages announced last week underscores President de la Madrid's commitment to austerity and reaffirms organized labor's backing of his economic policies. Minimum wages were boosted an average of 30 percent on 1 January, less than recent and projected inflation. As a result, labor will suffer another decline in real wages this year, but not nearly as large as experienced in 1983. The settlement, which is based on negotiations among the government, labor, and the private sector, is a traditional guideline for union demands throughout industry. Press reports indicate the administration will consider another increase in June, but, because de la Madrid views keeping a lid on wages as crucial to controlling consumption, reducing inflation, and maintaining IMF support, subsequent adjustments are likely to be small. [redacted] 25X1

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Union support has provided de la Madrid flexibility to implement painful austerity measures. Labor's willingness to make additional sacrifices suggests labor remains firmly in the ruling party's camp and reflects a continuing emphasis on job preservation. The modest wage hike will increase the President's chances of halving inflation in 1984 and meeting IMF-mandated reductions in public spending. Future labor support, however, is not unconditional. Big labor is likely to step up demands for improved nonwage benefits and tighter price controls on consumer items. [redacted] 25X1

Foreign Tiremaker Closes Venezuelan Operation

[redacted]

The recent plant closing by Uniroyal—one of Venezuela's largest tiremakers—indicates the difficulties the new Lusinchi administration will have in promoting foreign investment. According to the US Embassy, Uniroyal's decision—which idled 550 workers and one-fourth of domestic tiremaking capacity—resulted from tough government controls on business. During the past year, Uniroyal's losses mounted. The de facto devaluation boosted import and debt service costs, and strict domestic price controls squeezed earnings. 25X1 Moreover, foreign exchange controls hampered day-to-day operations by limiting the availability of dollars for purchasing imports and repaying debts. According to US Embassy reporting, the new Lusinchi administration plans to ease investment restrictions to attract new foreign investment. We believe, however, that foreign investors will remain reluctant unless the Lusinchi administration eases domestic economic controls as well. [redacted] 25X1

Labor Strike Deepens Suriname's Economic Turmoil

[redacted]

Suriname's three-week-old bauxite strike is dealing new blows to an economy already reeling from the suspension of critical Dutch aid in 1982 and has sparked the forced resignation of Prime Minister Alibux's cabinet. Army Commander Bouterse has blamed the Alibux government for the hasty imposition of revenue measures that initiatied the labor crisis and apparently has given in to the bauxite workers' demands to suspend tax increases on 25X1 income and selected commodities and postpone increases on import duties. So far, he has refused to rescind the tax on 1983 Christmas bonuses. [redacted] 25X1

The new government—to be appointed by Bouterse—will face severe economic problems. Foot-dragging on the imposition of such austerity measures as new taxes, public spending cuts, and foreign currency restrictions is likely to require more drastic measures later. We estimate that Suriname's foreign exchange reserves are sufficient to cover no more than one month of imports at current levels, and the bauxite strike is costing the country as much as $750,000 a day in foreign exchange earnings, according to the US Embassy. The bauxite sector contributes 80 percent of total export earnings and 20 percent of government revenues. It could take a month or more to regain aluminum industry production after the strike ends. [redacted] 25X1

Tunisia Rescinds Bread Price Increase

[redacted]

President Bourguiba's decision last week to restore bread subsidies may strengthen his popularity but could strain the economy and weaken Prime Minister Mzali. Bourguiba's announcement caused spontaneous demonstrations of support in the capital and calls for the removal of Prime Minister Mzali, whom Tunisians blame for the increases. Press reports indicate that the government has relaxed the security measures that had been put into effect to quell protests and that schools have reopened. [redacted] 25X1 25X1

The President has ordered the government to prepare a new budget within three months and has hinted that prices for petroleum and alcoholic beverages may rise. The government estimates that its subsidy compensation fund will cost about $200 million this year if subsidies are maintained. Tunis is likely to try to obtain more assistance from Western countries to offset its budgetary problems. [redacted] 25X1

Moroccan Concern About Economic Conditions

[redacted]

The government has put security forces in Casablanca on alert because of mounting tensions in poor neighborhoods. [redacted] Criticism of the austerity program has thus far been moderated by the government's assurances that the burden will be shared equitably and by its claim that belt-tightening is necessary to support the Saharan war effort—a popular nationalist cause. These explanations may be insufficient, however, to quell social unrest if there is a new round of food price hikes. In the absence of price increases, the extraordinary security precautions in Casablanca probably will forestall trouble. [redacted] 25X1 25X1 25X1

Iraqi 1984 Budget

[redacted]

A sketchy outline of Iraq's 1984 budget, approved earlier this month, points to another year of strict austerity. Although Minister of Trade Hassan provided no data, he stressed that top priority will be given to imports for defense and basic commodities. The investment program will focus on the completion of projects that support the war effort. The expansion of the Turkish pipeline—Iraq's only oil export route—will boost oil export revenues about 25 percent to $9.5 billion. This will not support more than a partial recovery in imports; last year imports dropped slightly more than 40 percent to an estimated $11 billion. Other oil export alternatives, including the proposed pipeline across Saudi Arabia, will not be ready to help in 1984. [redacted] 25X1 25X1

Zimbabwean Dissidence Threatens White Farming Community

[redacted]

The Mugabe regime's inability to prevent murders of white farmers by dissidents is testing the resolve of the country's important white farmers and ranchers to remain. These farmers account for 80 percent of total agricultural output and are crucial to food self-sufficiency. The killing of a farmer and his family late last month brings to 28 the number of whites slain during 1983. US Embassy sources report that farmers in the immediate area of the latest incident will ask the government to buy them out or resettle them in a safer district. The government is unlikely to accede to the farmers' request, for fear of setting a precedent and appearing to encourage a pullout by whites. [redacted] 25X1

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India Shocks World Tea Market

India last month banned new export sales of inferior grades of tea to provide adequate domestic supplies and reduce inflation. The unexpected action—India supplies nearly 30 percent of the world tea market—spurred panic buying in London and pushed prices to new highs. India's decision follows the imposition of controls on domestic tea producers and traders whom the government alleged were behind a 70-percent rise in domestic tea prices last year. Tea is a major consumer item in India, and, with elections no more than a year away, we believe concern about domestic prices takes precedence over exports.

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Communist

East Germans Raise Agricultural Prices

East Germany on 1 January took the rare step of imposing agricultural price reforms. Although details remain sketchy, the new policies include hikes in procurement prices reportedly averaging 50 percent for most farm products, sharp increases in prices for farm equipment and materials, and the imposition of farm rents based on land quality. These measures are designed to increase farm efficiency and specifically to boost fodder production to cut grain imports, which have been 2-3 million tons annually in recent years. Although the regime promises stable prices for basic foods and has increased price subsidies in the 1984 budget, it is likely to pass on some higher costs to consumers; travelers already report retail price increases.

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EC Budget Crisis Worsens

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The current EC fiscal crisis is forcing the Community to begin tackling its fundamental budgetary and agricultural problems. Soaring EC agricultural spending is rapidly exhausting revenues, while the United Kingdom and West Germany have threatened to block new tax measures until their budget payments are cut and the Community curbs farm spending. We believe at least some interim steps to redistribute the budget burden and cut agricultural spending are likely by the middle of 1984. The most likely solution is a compromise that limits members' net budget payments, modifies the Community's open-ended guarantee to underwrite agricultural overproduction, and increases EC revenues. Over the next several months, France and Italy will continue to press for agricultural reforms that attempt to make the United States a scapegoat for internal EC problems. As a result, the United Kingdom and West Germany may consent to some limited actions—such as import restrictions on corn gluten feed—as trade-offs in budget reform compromises.

EC: 1983 Budget *Percent*

Expenditures	
Agricultural support	69.8
Regional fund	6.9
Social fund	6.7
Rebates to members	5.3
Cooperation with developing countries	4.6
Administration	3.5
Research, investment, energy	2.6
Other	0.6
Revenues	
Value added tax	51.3
Customs duties	35.1
Agricultural levies	7.2
Sugar levies	4.7
Other	1.7

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The Issues

EC expenditures have soared in recent years and will top $22 billion in 1984. Spending is now approaching the legal cap on revenues. The problem stems primarily from rising agricultural costs because the Common Agricultural Policy (CAP) encourages overproduction by guaranteeing to purchase surplus output at prices above world market levels. Between 1976 and 1982, CAP expenditures rose at an annual rate of 17 percent, pushing CAP spending to slightly more than two-thirds of the EC budget. In 1983 CAP expenditures ran almost 30 percent ahead of the previous year. By early last October the Community had spent 95 percent of its regular budget allocation, and in November the Commission suspended advance payments on export subsidies and producer aids.

The EC by law must balance its budget annually, and this forces the Community to live within the resources allocated to it by member governments. The largest and only readily expandable source of EC revenue is the value-added tax (VAT). The other major source of money is customs duties raised through the Community's Common External Tariff. In 1975 the EC members agreed that up to 1.0 percentage point of each country's VAT would be made available for the Community budget as needed. This year, for the first time, the 1.0-percent VAT revenues will be insufficient to cover spending. The Commission projects a $1.3 billion shortfall for 1984. Although monies from VAT and customs duties rise with inflation and economic growth, EC spending as now planned probably will reach the projected revenue ceiling next September.

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EC: Net Budget Contributions, 1983 [a] *Million US $*

West Germany	2,533
United Kingdom	1,627
Belgium/Luxembourg	336
France	5
Denmark	−278
Netherlands	−316
Ireland	−648
Italy	−1,203

[a] Budget rebates are not included. Data exclude Greece because of special transition arrangements.

[redacted]

The EC faces the equally thorny budget problem of distributing the budgetary burden equitably. The United Kingdom has complained about the size of its net budget payments and is demanding changes. The British argue that, although they are one of the Community's poorer members—ranking seventh in per capita GDP, ahead of only Italy, Ireland, and Greece—Britain is the second-largest net contributor to the EC. Because a higher portion of UK trade is with countries outside the Community, it collects larger customs duties for EC coffers. Britain, however, receives relatively less CAP payments than most other members because it has a smaller and more efficient farm sector. [redacted]

West Germany, along with the United Kingdom, is also complaining about the size of its EC payments. Bonn, however, has signaled its willingness to remain a large net contributor. West Germany is the richest Community member and is a major beneficiary of the CAP and the open EC market for manufactured goods. [redacted]

A final budget issue is rebates. The European Parliament intensified pressure on the EC to solve the budget burden problem when it recently froze $980 million in British and West German rebates scheduled to be paid by 31 March. Since 1980 British demands for financial restitution have been met by annual rebates determined by the Council, usually after much wrangling. In a bold and possibly illegal move, the Parliament voted overwhelmingly to reclassify the rebates as "nonobligatory" spending—the only type over which it exercises control—and placed the money in a special reserve. Although the Parliament's action may be challenged by the Council in the European Court of Justice, a final disposition may not be possible before the March payment deadline. Should the rebate not be released, Prime Minister Thatcher has held open the possibility that the United Kingdom might retaliate by withholding its payments to the Community. London undoubtedly is wary of taking such a rash step, and progress on resolving budget issues could put off British action. [redacted]

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Potential Solutions

The Ten likely will agree on three interrelated measures to shore up the Community's finances: an immediate revenue increase to replenish the EC treasury, a reapportionment of net budget shares, and CAP reforms to curb runaway farm spending. [redacted]

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Expanding Revenues. If the Community is to remain solvent through the end of 1984, it will have to expand its financial resources. The most likely solution is raising the ceiling on the percentage of VAT passed to the EC by member states. Some countries, particularly France, Italy, and Ireland, favor this simple means of increasing Community finances because other states will carry a greater burden. The Commission has proposed raising the ceiling to 1.4 percentage points of VAT; this could provide sufficient revenues for a few years without changes in current spending policies. [redacted]

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Any increase in the VAT ceiling, however, must be passed by all 10 national parliaments. The United Kingdom and West Germany have indicated they will agree to an expansion of EC revenues only after other financial issues are settled. They insist on budget reforms to ensure permanent reductions

in their EC payments and demand that a lid be placed on agricultural spending. Other Community members recognize that Britain especially deserves some budgetary relief and favor some spending curtailments but have balked at an overhaul of the system. [redacted]

Redistributing the Budget Burden. A host of proposals aimed at redistributing budget shares have been put forward over the past six months, but none yet appears to have the support necessary for approval. The British have demanded a "safety net," which would place an absolute limit on the net annual contribution any member must make. Although this plan has been widely rejected in the past, Paris recently has tempered its objections, and this could lead to a compromise. The Germans recently tabled a compromise package that could be the basis for further discussions. The proposal combines the British plan for an upper limit on contributions with a Danish plan for increased expenditures in countries that are net contributors. [redacted]

CAP Reforms. To reduce agricultural spending, we believe the most likely target is the dairy sector. The Commission recently resurrected a longstanding proposal for $825 million in additional taxes on excess dairy production. Furthermore, the Commission has proposed a tax on vegetable oils and fats to raise $525 million, but this has drawn stiff opposition from the United Kingdom, the Netherlands, and West Germany. None of the proposals, to date, attacks head on the fundamental problem of agricultural overproduction stemming from EC subsidies. [redacted]

Prospects

EC members will negotiate budget issues intensively over the coming months, and, given the need to raise new revenues before next fall, changes likely will be agreed to by midyear. The "Special Council" meetings held in rapid sequence before the Athens summit probably will continue, but real progress is likely to be made in bilateral discussions. Despite the failure to achieve results at Athens, there has been surprisingly little recrimination, a good indication that EC members want a compromise. Much of the chance for success will depend on the ability of finance, foreign, and agricultural ministers to come up with specific proposals in the Special Council sessions; one of the major reasons for the deadlock at the Athens summit was the inability of political leaders to cope with the large, complex agenda tabled before them. [redacted] 25X1 25X1

Over the next several months, the EC Commission is likely to draw up a series of measures to contain agricultural price supports and export subsidies. We believe the Council will have little choice but to accept changes. Because VAT revenues will soon reach their ceiling, overall EC farm prices already are slated to grow only 4.4 percent this year—at least a 1-percent decline in real terms. The Commission has already announced measures that include a delay in support payments for grain, milk, beef, veal, and olive oil. These economies, however, are inadequate to avoid a cash shortfall next fall. [redacted] 25X1 25X1

The Council may agree to an increase in the VAT ceiling and measures to contain spending as part of a compromise package. The changes, however, must placate the United Kingdom by redistributing the budget burden and guaranteeing permanent limits on British budget contributions; London probably will not insist on recouping its entire $1.6 billion in net EC payments. West Germany will continue to underwrite a disproportionate share of the EC budget but will be unwilling to take on the British share. France, Denmark, and the Netherlands will be under the most pressure to increase payments. [redacted] 25X1 25X1

The agricultural reform measure most likely to be adopted in the near future is the dairy tax. Some attempts to curtail grain price supports may also be possible. The EC could resort to protectionist actions, such as import restrictions on corn gluten feed, as part of trade-offs to achieve budget compromises. Should the EC fail to raise revenues, the

Commission will be forced to consider more draconian steps, perhaps including a suspension of some CAP payments. [redacted]

We expect a preliminary settlement to the budget crisis at the EC summit in Paris on 25-26 June. Although the next EC summit will be held on 19-20 March, the complexity of the problems makes it doubtful the budget morass can be sorted out by then. Moreover, EC leaders probably will want to delay final agreement on any painful agricultural reforms until after the European Parliament elections in early June to avoid jeopardizing the farm vote. The June European Parliament elections will be an important test for national governments; in France they will be seen as a bellwether for the 1986 presidential election. In addition, the Ten may wish to postpone any new moves that detrimentally affect third countries—especially the United States—until after the London summit of industrialized nations on 7-9 June. [redacted] 25X1

Implications

An extension of the EC budget crisis to June will add to the growing conviction among some EC members that part of the cost of CAP reform should be borne by third countries, especially the United States. The French, for example, have argued that if their farmers must suffer so must exporters to the EC and that measures such as import restrictions on feed grain substitutes are necessary. The EC representative to the United States has frequently stated that, if CAP costs must be cut, Community agricultural import policies must be reexamined as well. [redacted] 25X1

The budget problems, however, could help mitigate some US-EC trade tensions. The EC cash crunch may constrain export subsidy spending as the Community is forced to limit spending. Additionally, EC members such as the United Kingdom, West Germany, and the Netherlands may argue that it is imprudent to provoke the United States while the EC is divided and in a weak negotiating position. [redacted] 25X1

[redacted] 25X1

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Status of the Soviet Gas Export Pipeline [redacted]

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A massive effort by the Soviets to accelerate pipeline construction and West European decisions to supply the originally contracted turbine-compressors appear to have overcome much of the disruption and potential delay caused by the US embargo. Pipelaying operations on the gas export pipeline were completed in September 1983, and construction of the compressor stations is proceeding apace. This effort undoubtedly entailed short-run costs to the Soviet economy by diverting resources from other uses—for example, by lowering the availability of 25-MW turbines for domestic pipelines. [redacted]

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We estimate that the Soviets will have enough compressor stations operational to transport at least the 7 billion cubic meters of gas tentatively scheduled for delivery in 1984. Overhead imagery confirms that Soviet 25-MW industrial gas turbines

Fire Reported at Compressor Station

Western press reports indicate that a fire and explosion at the Urengoy control center on the gas export pipeline has caused considerable damage. Gas Minister Dinkov's statement on Wednesday confirmed that a fire occurred but he stated that the damaged equipment would be replaced "in the nearest future." Although the extent of the damage and the nature of the control functions impaired are unknown to us, we believe the Soviets will be able to meet schedules for gas delivery to Western Europe in 1984. Indeed, spare capacity existing in the domestic gas pipeline network could be used as a short-run substitute. [redacted]

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[redacted]

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[redacted] 25X1

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When Is a Pipeline "Completed"?

The construction of a gas pipeline entails two major construction processes: laying the pipe and installing compressor stations. Typically, Soviet press statements take into account only the laying of pipe. Six to 18 months later, they report that the compressor stations are being brought on line and that the throughput of the gas pipeline is increasing. The Soviet press reported as late as October 1983, for example, that 17 compressor stations were planned for completion by the end of the year; in December they announced that two were in operation. [redacted]

will be installed on the export pipeline. [redacted] The Soviet turbines have not undergone extended testing and adjustment needed to ensure a high degree of reliability. Although this may affect the ultimate reliability of the export pipeline, the interconnection of the pipeline with other lines in the Soviet gas transmission network almost certainly assures that gas delivery commitments to Western Europe can be met. [redacted] 25X1

Massive Pipelaying Operations

Pipelaying operations on the 4,450-km gas export pipeline began in March 1982 and were completed last September. During the peak of construction, as many as 18,000 workers were assigned to pipelaying operations. The Soviets committed themselves to completing the gas export pipeline ahead of schedule as a riposte to the US embargo. The rapid pace of pipelaying, however, may have resulted in some slipshod construction. [redacted] anchoring operations in the swampy areas of West Siberia were not always completed properly and could result in sections of the pipeline rising to the surface during the summers. [redacted] pipe sections were cut into smaller pieces and

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flown by helicopter to construction sites after the spring thaw made the West Siberian roads impassable. This practice would require extra welding and increase the likelihood of leaks [redacted] 25X1

The resort to makeshift measures is not unusual in Soviet pipeline construction. Even when construction is undertaken at a slower pace, quality is usually below Western standards. Proper welding and insulating procedures are often sacrificed to simply getting the pipe laid and moving on to the next section. Although it is likely some sections may have to be reanchored and others rewelded, these problems will curtail operation of the gas export pipeline only for short periods. The Soviets normally employ permanent maintenance crews—stationed at intervals along a pipeline corridor—to make repairs and to ensure that interruptions are short. [redacted]

Compressor Stations

[redacted] the vast majority of the stations—33 out of 40 line stations—will be equipped with the US-designed 25-MW Frame V turbines [redacted] The minister in charge of pipeline construction stated that Soviet 25-MW and 16-MW gas turbines will be installed at as many as 22 compressor stations. [redacted]

We believe that the production level of the GTN-25 is not adequate to equip more than eight to 10 stations on the gas export pipeline by the end of 1984. According to USSR media reports, 12 GTN-25s were assembled during the January-September 1983 period. At this pace, the Soviets could produce another 12 GTN-25s by mid-1984. The original plans for the single-strand export piepline called for installation of three 25-MW units in each compressor station. [redacted] 25X1

The Soviet 25-MW Industrial Turbine

Despite Soviet claims that the GTN-25 turbine is already on a par with Western industrial 25-MW gas turbines, we believe the Soviet 25-MW unit will prove less efficient and less reliable. The newly developed Soviet turbines have not been adequately field tested. The compressor station for testing the prototype GTN-25s was only completed in mid-1983. Given the USSR's poor track record in gas-turbine design and production, we doubt that the Soviets could quickly achieve a high level of reliability and efficiency; in the West this takes several years. [redacted] 25X1

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Other Soviet Turbines

The current level of output of the 16-MW aeroderivative turbine, the GPA-Ts-16, is probably capable of equipping only a small number of compressor stations on the gas export pipeline. Only five GPA-Ts-16s were produced in 1982. The Soviet press reports that 55 units were planned for production during 1983 [redacted] the bulk of these turbines are planned for installation during 1984 on two domestic gas pipelines currently under construction. [redacted] 25X1

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Reliability of the Gas Export Pipeline

We estimate that turbine installation in at least 13 compressor stations could be completed during the first quarter of 1984. [redacted] 25X1

[redacted] USSR press reports indicate that the Soviets are planning to complete all the compressor stations by the end of 1984. Although the Soviets probably will not complete all of the compressor stations on schedule, deliveries of gas to Western Europe probably will not be affected. Should construction of the compressor stations on the export pipeline slow, we believe the Soviets could boost exports to at least 7 billion cubic meters by using available capacity in the domestic gas pipeline network. [redacted]

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If some of the Soviet turbines are taken out of service for unscheduled maintenance and repair, the capacity of the pipeline will not be significantly reduced. The 33 stations on the export pipeline using the Western Frame V turbines could deliver 90 to 95 percent of the pipeline's maximum throughput—about 27 billion cubic meters per year without any power input from the Soviet turbines.

[redacted]

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West European Gas Market: Frustrations for the Soviets

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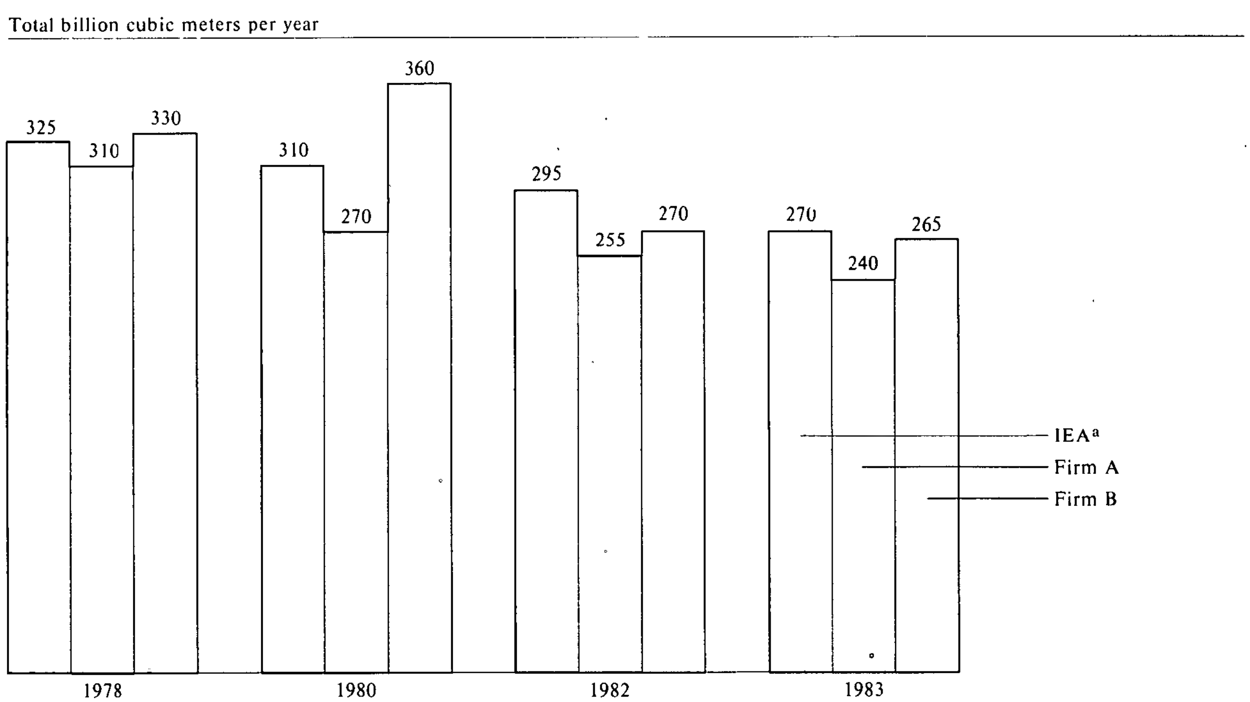
Reduced natural gas demand and a surplus of available supplies have sharply reduced West European willingness to buy Soviet gas in this decade. To date, the Soviets have been able to sell only about one-half of the amount of gas they envisioned when discussions began with West European purchasers in the late 1970s. As a result, Moscow has undertaken a concerted gas-marketing effort by cutting prices, tying sales of West European equipment to gas purchases, and attempting to penetrate new markets—an effort that has the potential to limit access of other suppliers to the European market. With the exception of Italy, however, prospects for major additional contracts for Soviet gas in the next few years are poor. Nonetheless, Moscow is still well placed to capture any growth in European demand in the 1990s. 25X1

Gas Demand: Diminished Expectations

Lowered prospects for economic growth, together with rapid escalation of European gas prices since

Western Europe: Changing Projections of Gas Demand in 1990



[a] Country submissions to the IEA plus France and Finland.

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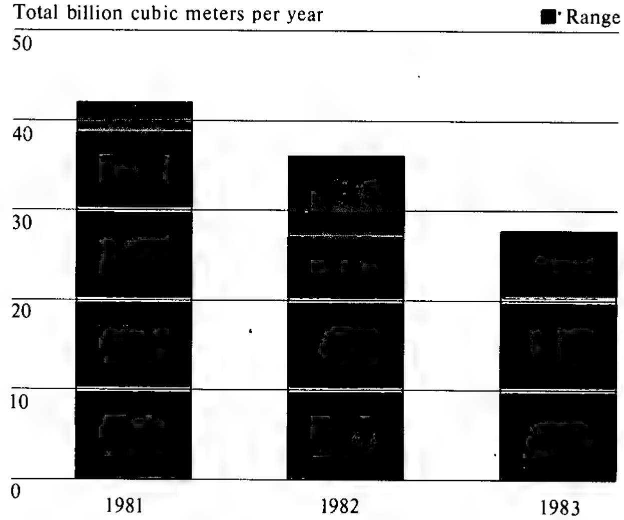
the late 1970s, have reduced sharply prospective West European gas demand. Government and industry demand projections for 1990 have been trimmed by nearly 20 percent since 1980. In addition, projections of indigenous European gas production are more optimistic. According to the US Embassy, Rome plans to maintain existing production levels—boosting 1990 Italian production estimates by over 60 percent compared with earlier projections. The Netherlands, Western Europe's largest gas supplier, recently authorized additional gas exports of up to 10-15 billion cubic meters (bcm) per year. As a result, West European net gas import demand in 1990 has been reduced by about 20 percent compared with projections made in 1982. In light of current supply contracts with the USSR, Algeria, and Libya, we believe the West Europeans now face a potential supply surplus of 5-10 bcm in 1990, forcing purchasers to take only the allowable minimum level from some contracts or shut in domestic production.

Western Europe: Changing Projections of New Soviet Gas Deliveries



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Pressures on the Soviets

Lowered projections of West European gas imports have diminished the potential volume of gas the Soviets can sell. As originally planned, the Siberia–to–Western Europe export gas pipeline was to have carried 40 bcm of natural gas annually. The pipeline, however, was scaled back to 29 bcm of deliverable capacity in early 1981, reflecting weaker gas demand. At present, the Soviets have lined up firm contracts with the West Germans, French, Swiss, and Austrians for only around 20 bcm. The Dutch and Belgians have dropped out as potential purchasers, and an Italian agreement, which still has to be formally approved, will probably be for far less gas than the Soviets originally expected. France, moreover, is looking to delay the buildup of new Soviet gas deliveries; Paris is considering reducing its 1984 purchase of new Soviet gas to one-half of the 1982 contract level, according to recent US Embassy reporting.

At the same time, Moscow faces lower gas prices and hence lower potential hard currency earnings. The recent decline in oil prices to which gas prices are tied has prompted purchasers to request a review of the pricing provisions in their contracts. Unless oil prices rebound, Moscow could be forced to lower prices still further. French and West German purchasers are presently seeking cuts in the base contract price of new Soviet deliveries, with Paris reportedly seeking a 10-percent reduction. Moscow will likely show flexibility by renegotiating key elements in these contracts in order to strengthen its image as a responsible gas supplier and secure sales it badly needs to increase hard currency earnings.

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Soviet Overtures

Faced with reduced sales prospects in most major West European gas markets, the Soviets have mounted an extensive marketing campaign to

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Western Europe: Projected Soviet Gas Deliveries

Billion cubic meters

	1982 [a]	1985	1990	2000
Existing contracts	**27.8**	**26.9**	**26.9**	**26.9**
Austria	3.0	2.5	2.5	2.5
France	4.1	4.0	4.0	4.0
Italy	9.3	7.0	7.0	7.0
West Germany	10.6	12.0	12.0	12.0
Finland	0.8	1.4	1.4	1.4
New contracts (Urengoy)		**9.7**	**17.5-21.7**	**17.6-21.8**
Austria		1.0	1.5	1.5
France [b]		2.5	6.4-8.5	6.4-8.5
West Germany [b]		6.0	8.4-10.5	8.4-10.5
Switzerland			0.4	0.5
West Berlin		0.2	0.8	0.8
Potential contracts			**10.0-13.0**	**12.5-15.5**
Italy [c]			3.0-6.0	3.0-6.0
Finland			1.0	1.5
Sweden			1.0	1.5
Greece			2.0	4.5
Turkey			2.0	2.0

[a] Actual trade.
[b] The range takes into account amounts of annual offtake under the new contracts that are subject to reduction by up to 20 percent under scheduled semiannual negotiations with the Soviets.
[c] We have assumed that any Italian-Soviet contract will be for far less than the 8 bcm originally agreed upon.

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promote gas sales to Italy and Finland and to penetrate markets in Sweden, Greece, and Turkey:

- To get a firm commitment from the **Italians,** Moscow intimated last spring that it might not purchase compressor units from Italy for installation along the pipeline. We believe the Soviets have apparently dangled lucrative equipment export contracts before the Italians—such as another Fiat truck factory and a coal-methanol-slurry pipeline—to prompt Italian industrialists to pressure the government. In November the president of Italy's industrial association—Confindustria—called for Italy to sign for Siberian gas to avoid jeopardizing Italian prospects in the next Soviet five-year plan.

- The Soviets have also offered to sell **Finland** and **Sweden** 3 bcm of natural gas annually by extending the current pipeline network in eastern Finland to Helsinki and then across the Gulf of Bothnia to Gavle near Stockholm. To entice the Finns and Swedes, the Soviets have marked gas prices down to near parity with coal. Moscow is also pressing the Finns to buy additional gas as a means of closing the bilateral trade gap.

- Moscow has been pressing **Greece** to import Soviet gas via an extension of the Soyuz pipeline from Bulgaria. According to industry trade journals, Greece has agreed in principle to import

Natural Gas Export Prices, 1983 [a] *US $ per million Btu*

Exporter	Price	Comment
Algeria	5.00 to 5.25	Price of LNG to European ports, c.i.f. including regasification costs.
Netherlands	3.70 to 3.80	Price at Dutch border.
Norway	3.80 to 3.90 4.50 to 4.70	(Ekofisk) (Statfjord) Estimated price at West Germany, c.i.f.; gas will not begin flowing until 1985 or 1986.
USSR	4.00	Base contract price for minimum volumes. Purchases above either the minimum or 80 percent of the contracted amounts are discounted.

[a] Price per million Btus can be converted to price per barrel crude oil equivalent by multiplying by 5.62.

Soviet gas, and plans are under way for conducting feasibility studies.

- Moscow has also offered to build a spur to supply 2 bcm per year of natural gas to **Turkey,** and the Soviets and Turks have already signed a joint protocol setting up a pipeline feasibility study.

Only Partial Success for Moscow

We believe lowered projections of gas demand, surplus supplies, and high costs for gas infrastructure development will largely thwart Soviet gas-marketing efforts during the next few years. Still, with the world's largest gas reserves and low production costs, Moscow's hard currency needs and its desire to limit other suppliers will almost certainly prompt the Soviets to make attractive offers to West European countries. Additional sales will be made if Moscow cuts prices substantially, but overall sales to Western Europe through the 1980s will remain well below what the Soviets would like. 25X1

Italy. Rome could defer new purchases of Soviet gas until at least the early 1990s. Even if Italy signs for Siberian gas because of political and trade considerations, we believe the volume will be far below the 8 bcm originally agreed upon—probably in the range of 3 to 6 bcm—and a lower base price will likely be negotiated. 25X1

Finland. Soviet sales efforts in Finland appear stymied by price factors. A Finnish Trade Ministry report completed last summer calls for a lower Soviet gas price to offset the large capital investment required to extend the existing pipeline to Helsinki—estimated at $140 million. Potential demand, moreover, has been cut to only 1 bcm, down by one-third compared with earlier projections. 25X1 Still, a dramatic price cut could get the project moving. 25X1

Sweden, Turkey, and Greece. Although these countries are considering gas imports, they presently 25X1 have no significant internal gas distribution networks. As a result, we believe high infrastructure development costs are likely to make Soviet gas an uneconomic proposition unless Moscow moves to cut prices. 25X1

Gas Security Implications in the 1990s

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Even if Moscow fails to win major additional sales in the 1980s, its marketing efforts will help set the stage for major gains in the 1990s. Specifically, Soviet willingness to cut prices, combined with gas surpluses in the 1980s, could delay or prevent development of additional alternative supplies. If new gas projects—such as the Norwegian Troll Field—are not undertaken in the next few years, these supplies will not be available in the early 1990s when forecasters expect West European demand to grow. Without competing alternative supplies, the Soviets, with 10-15 bcm of spare capacity

in exiting lines, would be well placed to capture an even greater share of the West European gas market in the 1990s. [redacted]

Price Cutting. Moscow's recent pricing practices portend stiff competition for other suppliers in the European market. In attempts to negotiate gas deals with the Finns, Swedes, and Greeks, the Soviets have shown a willingness to sharply cut gas prices to near parity with coal and heavy fuel oil. With Soviet energy sales accounting for over two-thirds of Moscow's hard currency earnings and with gas expected to partially replace oil in this trade, the Soviets will probably continue to undercut any competition. [redacted]

Tied Sales. The prospect of granting lucrative Soviet equipment contracts in return for gas purchases could put further pressure on West European countries to purchase Siberian gas in the 1990s. [redacted] the Soviets have been discussing with the Italians, West Germans, and others the possible construction of coal pipelines, each of which reportedly would involve an investment comparable to that required for the Siberia–to–Western Europe export gas pipeline. [redacted] Moscow already has plans for the construction of a 250-kilometer coal-slurry pipeline in central Siberia as early as the 1986-90 period, which could require foreign equipment and technology. [redacted]

Large-scale Soviet coal-slurry pipelines are highly speculative and would require overcoming several technical and economic problems. A linkage between gas sales and purchases of coal-pipeline equipment, however, would not only lure the West Europeans to purchase Soviet gas, but also would enable the Soviets to expedite development of their huge coal reserves. [redacted]

Barriers to Entry. If Soviet price cutting resulted in new gas sales to Sweden, Greece, or Turkey, Moscow could limit access of potential suppliers to the European market. An extension of the Finnish gas pipeline from the Soviet Union into Sweden would likely dampen Swedish interest in financing

Proven World Gas Reserves

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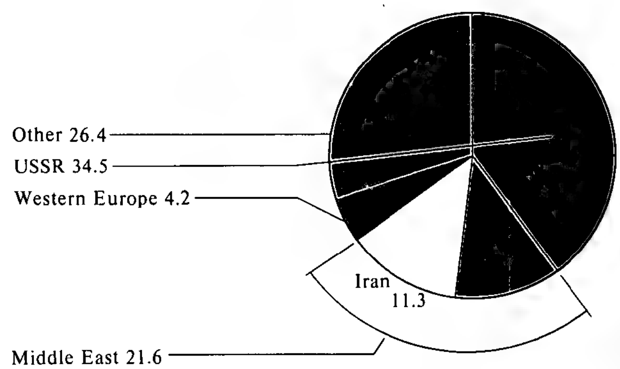
Total: 86.7 trillion cubic meters



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[redacted] 25X1

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and building a gas pipeline from the Norwegian Troms Field to the continent. Such a pipeline through Sweden is one alternative for bringing around 25 bcm of northern Norwegian gas annually to the European market in the 1990s, when it could limit dependence on Soviet supplies. Without Swedish participation in either financing or purchasing some of the gas, such a project would be more costly. A gas pipeline from Troms through Norway, rather than Sweden, would cost an additional 10 percent just because of construction factors, according to a preliminary study by Norsk-Hydro. [redacted]

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An extension of the Soviet pipeline network into Greece or Turkey could effectively block access to the European market by suppliers in the Middle East, where 45 percent of world non-Communist gas reserves are located. Markets in Turkey and Greece are key steppingstones for suppliers in the Middle East to enter the larger West European market because Middle Eastern suppliers will need

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Selected Natural Gas Pipelines

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to sell gas in transit to minimize the cost of delivery. By attempting to expand sales of its own gas to potential customers in Greece and Turkey, Moscow no doubt hopes to minimize the potential competition from Middle Eastern suppliers. Following extensive press reporting of a potential Iranian-Turkish gas deal, Moscow quickly signed a joint protocol in Istanbul setting up a pipeline feasibility study on the export of gas from the USSR to Turkey. Iran—with the world's second-largest gas reserves—has since abandoned all gas export projects in its present 20-Year Plan, and all gas production is slated for domestic consumption. Aside from financial and technical obstacles, Tehran may be concerned about antagonizing the Soviets by constructing a competing pipeline project. [redacted] 25X1
a Soviet-Greek gas accord would make potential network links to import Algerian gas or Iranian gas appear remote. [redacted] 25X1

[redacted] 25X1

Nigeria: New Leaders Face Old Economic Woes [redacted] 25X1

Nigeria's new military leaders have cited the sorry state of the economy and rampant corruption as justification for their takeover last month. Maj. Gen. Muhammadu Buhari has promised quick improvements in living standards, but we believe his government is not fully aware of the magnitude of the country's economic crisis. As the regime becomes increasingly aware of its inability to produce a rapid economic recovery, it could attempt to make the West and the international financial community scapegoats. In addition, we anticipate renewed coup plotting by more radical elements in the military who will claim the current group is little more than an extension of the inefficient and corrupt Shagari government. [redacted]

The Economy on the Eve of the Coup

Cuts in government spending necessitated by declining oil earnings have produced Nigeria's most severe economic recession since the 1967-70 civil war. We believe economic output in 1983 was roughly 20 percent below that of 1981. Nigeria was unable to boost oil production—the country's mainstay—due to the continued slump in world demand and OPEC restrictions on pricing and output. We estimate production for 1983 averaged about 1.3 million barrels per day. Oil revenues, which account for 95 percent of Lagos' total foreign exchange receipts and 80 percent of government revenues, reached only $11.2 billion in 1983, compared with a peak of $24.1 billion in 1980. [redacted]

The impact of this sharp decline in oil revenues was dramatic. Foreign exchange reserves dipped below $1 billion, compared with $10.2 billion at their 1980 peak. This occurred despite restrictions on imports imposed in April 1982 that reduced imports to the lowest level since 1976. Lagos experienced a $1 billion current account deficit in 1983 and saw its total unpaid bills swell to an estimated $7 billion last summer. The import slowdown affected primarily machinery and industrial inputs, forcing many factories to close and boosting urban unemployment to about 30 percent. [redacted] 25X1

Only in the last six months did the former Shagari government begin to deal with a financial crisis that threatened to shut off the country's access to international credit. Last summer, Lagos rescheduled $2 billion in commercial debt and began talks with the International Monetary Fund regarding a $2.5 billion Extended Fund Facility. Lagos more recently sent its senior financial officials to query international banks about rescheduling the remaining $5 billion in unpaid trade bills. [redacted] 25X1 25X1

The former government did little, however, to help promote its case in dealing with either the banking community or the IMF. The Nigerians fell behind in paying obligations incurred after the July and September reschedulings. In addition, Lagos was chronically late to rescheduling meetings [redacted] Moreover, former President Shagari publicly stated his opposition to the Fund's insistence on a hefty devaluation and reportedly was unwilling to commit Nigeria to a tough austerity program as long as the question of IMF financing remained unresolved. Even before the change in government, we did not anticipate that a letter of intent would be signed before January, with disbursements not expected before March; we believe an agreement is now even further off. [redacted] 25X1 25X1 25X1

More of the Same

Prospects are not good for a significant economic turnaround any time soon. Nigeria will be lucky to

keep this year's oil production at its OPEC-mandated ceiling of 1.3 million barrels per day if, as expected, the soft oil market persists. In addition, official prices are not expected to firm beyond the present average of $30 per barrel. Only a major disruption in the international supply of oil would allow Lagos to ease its financial crisis through a major increase in oil revenues.

Despite this oil market outlook, we anticipate Lagos's hard currency needs will prompt the new government to request an increase in Nigeria's production quota. OPEC refused in December to entertain Shagari's plea for a larger production share. Head of State Buhari, chairman of the Nigerian National Petroleum Corporation during the country's last military government, will almost certainly remind his OPEC colleagues—particularly the Saudis—that the alternative might be a unilateral reduction in prices of Nigerian crudes. Officials of the Nigerian National Petroleum Corporation claim that Lagos must be allowed to increase production to 1.5 million barrels per day or will lower prices by 25 to 50 cents per barrel. Last year Shagari's civilian government cut prices in response to a price cut by the British and to pressure from international oil companies, resulting in the first reduction ever in OPEC prices.

Buhari may raise the possibility of pulling Nigeria out of OPEC if, as we expect, the organization refuses either to authorize Lagos higher production levels or to offer some kind of financial assistance. We doubt, however, that Buhari would carry out such a threat. We believe he realizes that boosting output by lowering prices could provoke other OPEC members to invoke retaliatory measures that could result in even lower oil revenues to Nigeria. Instead, the Nigerian Government probably will try to increase production gradually by offering price discounts or other concessions and then see how OPEC and the international market react. Moreover, Lagos could drop its longstanding objection to oil barter deals, particularly if such arrangements are structured to finance priority development projects.

Government Options

In the absence of an unlikely surge in demand for Nigerian oil and assuming Buhari sticks to his early promises to respect financial obligations and pursue austerity, the new regime has a limited number of options available to deal with the economic crisis. These include: 25X1

- Maintaining the former government's import restrictions.
- Rescheduling short-term commercial arrearages.
- Securing an IMF financial package.
- Negotiating a new payments schedule for medium- and long-term obligations. 25X1

Simply maintaining import restrictions would not be sufficient to deal with Nigeria's foreign financial problems. The low level of commodity imports required to keep Nigeria's current account in balance—around $750 million a month—is already below the level of $800 million monthly that international bankers believe is necessary to prevent major damage to the modern sectors of the economy. The import problem will be even more severe in 1984 as a boost in food imports—particularly corn—is likely to be needed to offset the current drought and to garner political support from urban consumers tired of shortages and high prices. A 25X1
further reduction in industrial imports, however, would worsen the trend of widespread business closings and unprecedented urban unemployment.
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We believe the need to expand imports will compel the new government to pursue more than just import restrictions. We anticipate Lagos will attempt to reschedule all outstanding commercial trade credits and will seek to negotiate an IMF program. Lengthening the repayment schedule on commercial debt and an IMF loan would ease Nigeria's immediate cash flow problems, although Lagos could still face a 1984 foreign financial gap on the order of $3 billion. We believe that international banks would agree to cover part, but probably not all, of this shortfall but only after agreement is reached on arrearages and on an IMF 25X1
accord.

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Financial Gap Methodology

To analyze the political and economic consequences of various economic options, we have constructed three financial gap scenarios. Each consists of a current account balance, principal payments due on outstanding debt, short-term trade arrearages, and IMF disbursements. We have excluded foreign reserve holdings in our projections because Nigeria has been reluctant to allow reserves to fall much below $1 billion. [redacted] 25X1

Our current account projections are adjusted so that only Nigeria's interest payments are varied: We held constant at 1983 levels all other components of the current account. We assumed that Nigeria remains current on the interest owed on rescheduled debts. [redacted] 25X1

These scenarios allow us to focus on the impact on the Nigerian debt burden of various likely outcomes of upcoming financial negotiations. The trade outlook, however, includes only a "best case" projection. For example, although we expect oil earnings in 1984 to approximate 1983 levels, international oil market developments could result in much lower petroleum receipts. In addition, holding imports at last year's low levels could be very difficult politically, especially if an increasing share of foreign exchange must be used for imported food as a result of the drought. [redacted]

Nigeria: Financial Scenarios, 1984 *Billion US $*

	Case 1 [a]	Case 2 [b]	Case 3 [c]
Trade balance	3.5	3.5	3.5
Exports (f.o.b.) [d]	12.5	12.5	12.5
Oil	12.0	12.0	12.0
Nonoil	0.5	0.5	0.5
Imports (f.o.b.) [e]	9.0	9.0	9.0
Net services	−3.3	−3.8	−2.6
Freight and insurance	−1.4	−1.4	−1.4
Investment income	0.1	0.1	0.1
Gross interest on external debt	−1.6	−2.1	−0.9
Other services	−0.4	−0.4	−0.4
Current account balance	0.2	−0.3	0.9
Debt repayments (principal)	2.7	3.6	1.6
Short-term arrears	−5.0	0	0
IMF disbursements	0	1.0	1.0
Financial gap	**−7.5**	**−2.9**	**0.3**

[a] Assumes no rescheduling of external debt payments due in 1984 other than $2 billion rescheduled last summer and no IMF agreement.
[b] Assumes rescheduling of all short-term arrears and an IMF agreement.
[c] Assumes rescheduling of all external debt payments due in 1984 and an IMF agreement.
[d] Assumes oil production of 1.3 million b/d with average prices of about $30 per barrel and consumption of 200,000 b/d.
[e] Assumes imports remain at 1983 levels in nominal terms.

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[redacted] 25X1

Lagos last week announced plans to retain at least some of the former government's senior economic advisers, indicating that talks on an IMF program and debt rescheduling could begin soon. Nevertheless, we expect Buhari—under domestic pressure to improve living standards—could take an even tougher stance than the previous government on austerity measures. As a result, we believe negotiations will be difficult and protracted. Even before the coup, discussions were complicated because the IMF was insisting that Nigeria reschedule arrearages before the IMF would agree to a program, while the banks were refusing to reschedule arrearages until there was substantial progress toward an IMF adjustment package. [redacted] 25X1

Political Costs of Economic Reform

Public support for Buhari and his military government is likely to erode quickly as Nigerians fail to see any improvements in living standards resulting from austerity. The Yoruba west—Nigeria's most

economically developed but potentially restive region—has been hard hit by the economic slump. Buhari will face an uphill struggle gaining Yoruba backing in and out of the military for new austerity measures. Furthermore, continued economic stagnation is likely to weaken the military's cohesion and spawn coup plotting. [redacted] junior- and middle-grade officers may be upset with their underrepresentation in the government and its generally conservative bias. [redacted]

Implications for the United States

In the short run, Buhari is likely to place US economic help high on his list of priorities. In particular, Lagos would like the United States to intercede with the IMF and international lenders so that Nigeria can obtain better terms. Buhari undoubtedly will hope that US intercession would make austerity measures more politically palatable. [redacted]

There are other options that Buhari probably will want to explore with US officials. Lagos is likely to request commodity credits and emergency food aid, particularly if drought conditions in northern Nigeria prove as severe as are now predicted. Buhari, with his experience in petroleum matters, could renew efforts to sell crude to the US Strategic Petroleum Reserve. Although Lagos previously refused to sell oil at less than its official price, Buhari may now prove more accommodating. Nevertheless, he may try to persuade Washington to pay official prices as a goodwill gesture. [redacted]

Continued economic deterioration, especially if accompanied by difficult negotiations with the IMF and international lenders, risks Nigeria's resentment against the United States. This could tempt the new government to make Washington and the West scapegoats for the country's woes. Furthermore, Buhari could attempt to deflect attention from domestic economic conditions by adopting a more strident posture toward the United States on African political issues, particularly the pace of negotiations on Namibian independence. [redacted]

[redacted]

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Nicaragua: Economic Impact of the Insurgency

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Sandinista leaders, blaming the insurgents for widespread disruptions in the economy, are appealing for increased international aid. Despite these claims, we estimate that the total direct and indirect damage inflicted on the Nicaraguan economy by the anti-Sandinista insurgents since last July is no higher than $60 million but probably is considerably less. These losses—at most 2 percent of GDP—have accelerated slightly a two-year economic slide caused by reduced foreign lending, the junta's highly centralized economic policies, and low world commodity prices. Nonetheless, with output already 25 percent below prerevolutionary (1978) levels, Sandinista leaders worry that even the small additional economic hardships imposed by the insurgency are eroding popular support for the regime. Moreover, the insurgents have the ability to disrupt hard currency earnings and vital imports by attacks on shipping. Moscow recently began shipping petroleum to the Sandinistas, and we believe Managua's reliance on Soviet economic assistance will escalate in 1984.

Insurgent Strategy and Actions

Since the insurgents began their systematic attempts to undermine the economy in July 1983, they have hit a wide variety of economic targets, ranging from oil storage tanks to tobacco barns and customs posts. The economic damage incurred in these raids has stemmed primarily from the attacks on oil facilities. We believe the costliest single attack was the October raid on the western port of Corinto, which stores large quantities of fuel and handles about 85 percent of foreign trade. The insurgents are striking increasingly at transport networks and other nonenergy economic targets. They are hampering—though not seriously—commerce and agriculture in the interior by blowing up bridges, interdicting roads, and damaging road construction equipment. Major attacks on towns—particularly on Pantasma and Ocotal—have inflicted some damage to roads and buildings. 25X1

The guerrilla strategy of attacking oil facilities—and the relatively little damage inflicted on Nicaragua's vital agricultural sector—contrasts markedly with the aims and successes of the insurgents in neighboring El Salvador. The Salvadoran fighters, for example, have severely disrupted commerce and agriculture in the countryside by repeatedly attacking electrical facilities, destroying crops, and more systematically intimidating farmers. 25X1

Estimating the Costs

Based on an analysis of direct damage and junta leaders' public statements, we consider $60 million—about 2 percent of Nicaragua's output in 1983—as the upper limit for the total value of direct and indirect damage. We believe, however, 25X1
the actual damage probably is closer to $30 million. Outlays in response to the damage are lower; many facilities have yet to be rebuilt, and in some instances the Nicaraguans have simply done without the lost material. In contrast, the Nicaraguan Foreign Minister has claimed that insurgent attacks cost—both in direct damage and lost production—just over $100 million in all of 1983. 25X1

The largest direct costs stem from the destruction of petroleum facilities. We estimate total damages from the Corinto raid at $5 million, including the loss of $2 million worth of diesel fuel. Sabotage of Puerto Sandino oil import facilities early in the fall delayed the delivery of scarce crude oil and cost about $300,000 to repair. In addition, a seaborne commando raid against fuel stored at the eastern

Nicaragua: Summary of Major Insurgent Attacks Against Economic Targets, 1983

Target and Date of Raid	Extent of Damage	Impact of Raid and Status of Reconstruction
Sisin Highway Bridge 13 July	Bridge intact but heavy trucks must lighten load or bypass bridge.	Disrupted local mining and forestry traffic. Status of reconstruction unknown.
El Tuma Highway Bridge 10 August	Destroyed.	Disrupted traffic in north-central region. Repair work started last fall.
El Jocote Highway Bridge 21 August	Destroyed.	Interrupted traffic. Bypass under construction by late September.
Puerto Isabel 24 August and 2 October	Destroyed 9,000 barrels of fuel and some storage facilities.	Local mining/sawmill operations impaired, and damaged pier curtailed shipping. Status of repairs unknown.
Puerto Sandino Oil Import Facility 14 and 23 October	Damaged offshore buoys and floating pipeline.	Repaired within three weeks.
Transmission Towers 25 September	Destroyed.	Interrupted electricity to western Nicaragua and Honduras for about two weeks. Repairs completed.
Ocotal Highway Bridge 27 September	Damaged upper bridgework and supports.	Restricted transportation on main highway. Reconstruction completed by 22 October.
Corinto Port Facility 11 October	Destroyed four fuel tanks and 70,000 barrels of fuel and damaged containerized cargo crane.	Reduced total fuel storage capacity in Corinto by about 20 percent and slowed containerized shipping temporarily. Crane operable by 22 October, but no repairs to fuel tanks as of early November.

[redacted] 25X1

port of Puerto Isabel destroyed some $350,000 worth of petroleum and equipment. [redacted] 25X1

The indirect costs of the insurgency—those that reach beyond replacement values of plant, equipment, and goods—are hardest to estimate, and we have not gone beyond a rough calculation. The insurgents have destroyed the equivalent of a week's worth of fuel consumption, and—in a country where fuel is already rationed—this is certain to slow the economy. Gold-mining operations—which accounted for some 4 percent of Nicaragua's export earnings in 1982—were probably slowed by the destruction of fuel at Puerto Isabel, the single source of petroleum for the mines. Destruction of some small electric power facilities in the interior has disrupted local economic activity for limited periods. [redacted]

Insurgent attacks against transportation facilities have hampered commerce and agriculture. Although most disruptions apparently have been temporary, the interdiction of traffic on east-west supply routes has kept some harvested export crops bottled up in the interior. The Sandinistas have been forced to rely on aircraft and slower sea transport to supply northeastern Nicaragua. [redacted] 25X1

[redacted] 25X1 The slump in demand for Nicaraguan sugar, particularly if it spreads to other commodities, will prompt Managua to redouble sales efforts to such sympathetic regimes as those in Libya, Iran, and Eastern Europe. That task will be made even harder by the

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Major Insurgent Attacks Against Economic Targets, 1983

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extra $18 million worth of sugar Managua has to sell in 1984 because of the cut in its US sugar import quota.

The insurgency has not yet prompted the regime to spend significantly more on defense and security. Spending in 1983 for these purposes showed no real increase over the more peaceful year of 1982, according to government statistics. We believe that most of the $200 million budgeted for security (15 percent of total spending) and a fair portion of troops on active military duty (totaling 30,000 to 35,000, including reserves and militia) would have

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been used to establish a sizable military infrastructure, even if Nicaragua were not facing an insurgency. The Sandinistas would have created and trained large reserve and militia forces to maintain a credible threat against their neighbors and to consolidate control over the population. Spending on arms and ammunition to fight the insurgents is minimal; Nicaragua receives most supplies from Cuba and the Soviet Union free of charge.

Searching for Help

The Sandinistas' other major economic headaches remain. These include:

- A severe shortage of foreign exchange.
- A $3 billion foreign debt.
- Foreign banks' refusal to extend new credits.
- Growing shortages of skilled labor.
- Continued low commodity export prices.

These difficulties, combined with the cost of the insurgency, have forced Nicaragua to rely on foreign aid.

We believe that in 1983 Managua received total disbursements of at most $544 million, notably from Mexico and the Soviet Bloc. This is well short of the roughly $635 million in foreign aid that was needed to keep the economy from losing ground last year. Under the weight of accumulated economic difficulties, we believe real output sank 2 to 3 percent in 1983.

In their appeals for international aid, the Sandinistas have emphasized the insurgency and their need for additional resources to defend the country rather than the economic problems predating the insurgency. Despite stepped-up levels of insurgent activity, however, total aid in 1983 remained at about 1982 levels. Western aid comprised a noticeably smaller share—about 55 percent compared with 70 percent in 1982. Western grants in kind and supplier credits are of greater benefit to Managua than those from the USSR because of the usually superior quality and wider range of Western products.

Nicaragua: Estimated Drawdowns of Official Foreign Economic Aid [a] *Million US $*

	1982	1983
Total	**512**	**544**
Mexico	145	140
USSR and Eastern Europe	40	116
Western Europe	68	114
Middle East	85	60
South America	80	27
Multilateral institutions	69	22
Other	25	65

[a] Including grants, loans, and supplier credits.

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Mexico remained Nicaragua's largest single source of new credit in 1983. Mexican financing primarily covered $138 million worth of oil—sufficient to cover nearly all of Nicaragua's petroleum consumption in 1983. 25X1 25X1

Although Managua had access to about $350 million in open lines of supplier credits and technical assistance from the **Soviet Union** and **Eastern Europe** in 1983—equivalent to about one-half of its total imports—we estimate that it drew down only $100 million and received another $16 million in donated goods. Nicaragua's ability to absorb large-scale economic credits from CEMA countries has been limited because most machinery and equipment is of Western origin, despite some retooling to accommodate equipment from Communist suppliers. 25X1 25X1

Cuban-origin economic assistance consisted heavily of providing skilled labor for such ongoing projects as building a new sugar mill and improving railroads; this help does little to alleviate immediate economic problems. 25X1

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Hard currency assistance from **Libya** may have increased markedly in late 1983.

OECD states, other Latin American countries, and multilateral institutions provided about $160 million in loans and grants. We believe the largest single component of this assistance consisted of supplier credits from Spain, extended in part to bolster Spanish exports but also in the vain hope that Madrid could thereby exercise some moderating influence over Managua. Multilateral assistance was restricted to relatively small project loans because Managua continues to reject an IMF program.

1984 Outlook

It would take sustained and repeated insurgent attacks to seriously damage the economy's basic infrastructure. We cannot judge whether the insurgents would be in a position to inflict such damage over the next year. Nonetheless, the insurgents could disrupt hard currency earnings and vital imports. Attacks against ships or port facilities could cause insurance costs to become prohibitive, and loss of such key imports as petroleum would hit hard throughout the economy. The regime also worries that the ongoing insurgent drive in Nueva Segovia Department may seriously disrupt the coffee harvest now in progress.

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Nicaragua's most immediate concern is to secure financing to import the $145 million worth of oil it needs in 1984 to merely run the economy at the 1983 level. Although we expect Mexico will continue to extend credit for its deliveries, Pemex is scheduled to reduce shipments by about one-fifth beginning in February—a drop of about $25 million annually.

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The Soviet Union has apparently decided to fill at least part of this petroleum gap. Between late December and early February, Soviet tankers are expected to deliver crude oil and refined products. These deliveries are the first known shipments of Soviet oil to Nicaragua, These deliveries indicate a marked departure from past Soviet economic aid policy toward Nicaragua. The USSR generally has allowed Managua to draw down credits or use soft currency to buy Soviet manufactures that—unlike oil—Moscow cannot easily sell for hard currency on world markets. A new role for the USSR as oil supplier—combined with a heavier drawdown of Soviet and East European supplier credits as Western banks continue to refuse new loans—increasingly will force Managua into the position of a Soviet economic client.

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International Financial Situation: Resistance to Austerity [redacted]

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This article is part of our series focusing on the economic and political aspects of the international financial situation. [redacted]

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Debt-troubled LDC governments will be hard pressed to continue austerity this year in the face of falling per capita incomes and growing unemployment. Price hikes and tax increases have spurred urban disturbances; problems in Tunisia, Suriname, and Jamaica are only the most recent examples. Although the contraction of international credit provides little maneuvering room, we believe increasing numbers of debt-troubled LDCs will take the economic risk of relaxing austerity in an effort to ease growing domestic political pressures. [redacted]

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Key Debt-Troubled LDCs: Real GNP Growth — *Average annual percent*

	1971-80	1981-83	1984 [a]
Argentina	2.1	−3.6	3.0
Brazil	8.8	−2.9	−3.0
Chile	3.3	−3.0	3.0
Costa Rica	5.5	−4.8	0
Ecuador	8.9	−1.5	1.0
Indonesia	5.3	4.2	1.5
Ivory Coast	6.5	1.7	0
Kenya	5.5	2.8	3.0
Mexico	6.3	0.8	0
Morocco	5.7	1.6	4.5
Nigeria	6.6	−4.9	−5.0
Peru	3.4	−0.4	0
Philippines	6.3	2.8	0
Venezuela	4.2	−1.8	−3.5
Zaire	0.1	−0.2	0

[a] Projected.

[redacted]

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Impacts of Austerity

Austerity programs have caused moderate-to-severe contraction of LDC economies. Between 1980 and 1983, nine of the 15 key LDC debtors suffered significant declines in real output.[1] Manufacturing in particular slowed dramatically as processors experienced trouble obtaining needed inputs. [redacted]

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As new foreign exchange controls and tight money policies have taken hold, the private sector has been hard hit. Bankruptcies have increased sharply in Mexico and Brazil, and the Venezuela Chamber of Commerce predicts bankruptcies there will begin to rise. Philippine electronic firms—a major source of nontraditional exports—are no longer able to repay foreign or domestic loans; [redacted]

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Public-sector projects have felt the crunch as well. Venezuela's Orinoco oilfield project has been curtailed; Mexico is also scaling back development projects. [redacted]

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A Slight Wavering

Popular willingness to endure more austerity is weakening in the face of the fourth straight year of declining real per capita incomes in most LDCs

[1] The 15 key debt-troubled LDCs are Argentina, Brazil, Chile, Costa Rica, Ecuador, Indonesia, Ivory Coast, Kenya, Mexico, Morocco, Nigeria, Peru, Philippines, Venezuela, and Zaire. [redacted]

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and dim prospects for a quick recovery. In some key countries—notably Brazil and Chile—public disgruntlement has been openly expressed. Most recently:

- Nigeria's new military leaders cited corruption and mismanagement as reasons for the coup but now must attempt to reconcile promises to improve living standards with IMF requests to devalue, reduce imports, and end subsidies on many consumer goods.
- The Peruvian Government took heavy losses in the December elections, as the opposition American Popular Revolutionary Alliance campaigned against worsening economic conditions.
- Riots erupted in Tunisia in response to bread price hikes, which were quickly rescinded. 25X1

Although most of the key debt-troubled LDCs are sticking with austerity, they are attempting to mitigate the hardships:

- The new Venezuelan Government has indicated that a jobs program for the unemployed will be developed and has not ruled out the possibility of wage increases.
- Buenos Aires plans to curb military spending while instituting price controls and increasing all salaries—56 percent for those at the minimum wage. In addition, price controls have been placed on important consumer goods for the next 40 days.
- The Government of Brazil is using a sliding scale for wage adjustments in the indexation law passed in November to ease the burden on the lower-income class.
- The new Mexican budget has a $1.65 billion reserve fund to be used to generate employment and support investment if economic recovery is not evident in the first quarter. Another $900 million is budgeted for a program creating 300,000 to 400,000 jobs.
- Chile is increasing spending on housing, developing financial relief programs, and hiking public salaries in response to urban discontent. 25X1

We expect debt-troubled governments to take additional steps to ease the burdens of austerity. The coup in Nigeria is likely to be cited by other leaders to justify such moves. 25X1

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LDC Austerity Programs

Austerity programs have several common features:

- Import restrictions. *Of the austerity measures taken, import reductions have had the greatest impact on many of the debt-troubled countries. The reductions have been carried out through import duties or special surcharges, as in Chile, or through the slowed or halted issuance of import licenses, as in Kenya.*
- Reduction in subsidies. *The austerity measure most directly felt by the populace, and therefore one of the least popular, has been the cutting back of food and fuel subsidies. Indonesia, Venezuela, Nigeria, Brazil, the Philippines, Morocco, and Costa Rica all have reduced or eliminated consumer subsidies.*
- Increased taxes. *Governments also have levied new or higher taxes. Chile, for example, has raised fuel taxes. The Moroccans have a new head tax on citizens leaving the country, and Brazil has levied new taxes on investment funds, mutual fund earnings, and on corporate and company earnings from resale of credit instruments. Indonesia, Argentina, Mexico, Chile, and Peru also announced plans for stricter enforcement of existing taxes.*
- Devaluation. *Currency devaluations have made imports more expensive, pushing up consumer price indexes and lowering real income.* 25X1

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